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No. 07-(1)

IN THE

Supreme Court of the United States

SEMEN LEYKIN, *et al.*,

Petitioners,

v.

AT&T CORPORATION, *et al.*,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

The control person of the issuer of stock used lies to the market for that stock to misappropriate the issuer's intellectual property ("IP") and customers. Initially, the control person's deceptions increased the price of that stock while the control person successfully misappropriated certain parts of the issuer's IP. Later, the control person's lies somewhat decreased the stock price in order to gain increased control over the issuer and pressure the management of the issuer into complying with the control person's demands for the most sensitive portions of the issuer's IP. After completing its misappropriation of the IP, the control person consummated its scheme by forcing the issuer into bankruptcy and taking its customers. Plaintiffs purchased the issuer's stock at the increased market prices and sold the stock at the somewhat decreased market prices caused by the control person's scheme.

The questions presented are:

1. Whether an integrated scheme of misrepresentations and the unlawful acts they conceal qualify as a scheme or artifice in connection with the purchase or sale of the security within the meaning of Securities and Exchange Commission ("SEC") Rule 10b-5, 17 C.F.R. § 240.10b-5, or, as the Court below held, a scheme in connection with the purchase or sale of the security is limited to misrepresentations and excludes the associated deceptive or unlawful acts they are designed to conceal?

2. Whether pleading loss causation in a Rule 10b-5 scheme claim requires merely allegations that the "act . . . of the defendant alleged to violate this chapter caused the loss" as set forth in 15 U.S.C. § 78u-4(b)(4) or, as the Court below held, plaintiff must invariably plead that loss was caused by either a disclosure to the market of the misrepresentation or a materialization of the risk concealed by the misrepresentation?

RULES 14.1 AND 29.6 STATEMENT

Petitioners (plaintiffs-appellants below) are Semen Leykin, Frank Thomas, Ken Pearlman, Mike Katto, At Home Suit Group, Inc., Kurt Buettler, Gerry Galiger, Stan Cohn, Channa Unger, Michael Eksler, Frieda Eksler and Ronald Ventura.

At Home Suit Group, Inc. has no parent corporations and no publicly held companies own 10% or more of its common stock.

Respondents (defendants-appellees below) are AT&T Corporation, C. Michael Armstrong, Mark McEachen, Frank Ianna, Charles H. Noski, Daniel H. Somers, Hossein Eslambolchi, Raymond Liguori, and Mohan Gyani.

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Petitioners, purchasers of the publicly-traded stock of Excite At Home Corp., respectfully petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Second Circuit.

OPINIONS BELOW

The opinion of the court of appeals (Petition Appendix ("App.") 1a-5a) is reported at 216 Fed. Appx. 14. The opinion of the district court (App. 6a-45a) is reported at 423 F.Supp.2d 229.

JURISDICTION

The judgment of the court of appeals was entered on January 30, 2007. Petitioners filed a timely petition for rehearing and rehearing en banc on February 14, 2007, which was denied by order dated July 9, 2007. App. 54a-55a. This Court's jurisdiction is invoked under 28 U.S.C. § 1254(1).

STATUTES AND REGULATIONS INVOLVED

The relevant statutory and regulatory provisions, Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b) (the "Exchange Act"), Section 21D(b)(4) of the Exchange Act, 15 U.S.C. § 78u-4(b)(4), SEC Rule 10b-5, 17 C.F.R. § 240.10b-5, and SEC Regulation S-K, Item 404(a), 17 C.F.R. § 229.404(a), are reproduced at App. 56a-58a.

STATEMENT OF THE CASE

1. The AT&T Defendants' Scheme To Lie To The Market For At Home Stock In Order To Misappropriate At Home's Proprietary Technology And Customers

Plaintiffs, including lead plaintiffs Frank Thomas and Ken Pearlman, bought Excite At Home ("At Home") common stock between November 8, 1999 and September 29, 2001 ("Class Period") at the prices prevailing on the efficient NASDAQ market for At Home stock. ¶¶13-14,Ex.A;JA2081,2154.

The prices at which they purchased and sold the stock were based on defendants' public statements and other publicly available information. *Basic, Inc. v. Levinson*, 485 U.S. 224, 246-247 (1988).

2. At Home's "Critical" Proprietary Technology Entitled At Home To 30% Of AT&T's Revenues From At Home's Service

Through its patented and other intellectual properties, At Home enjoyed a dominant position in bringing high-speed Internet access to homes and businesses over existing cable television lines. ¶¶2,55;JA2078,2091-92.

So superior were At Home's proprietary technologies that large cable television companies were At Home's principal customers, owned a majority of its voting stock,

and held a majority of the seats on its Board of Directors.[1]

AT&T Corporation ("AT&T") was the largest shareholder of At Home. ¶39(r);JA2104.

As a company with publicly traded stock, At Home made regular filings with the Securities and Exchange Commission ("SEC"). These filings were signed by directors of At Home, including those AT&T defendants who were At Home directors. ¶¶20-35;JA2082-86. Also,

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1. The AT&T defendants are AT&T Corporation ("AT&T"), C. Michael Armstrong, Frank Ianna, Mohan Gyani, Charles H. Noski, Daniel H. Somers, John C. Petrillo, Raymond Liguori and Hossein Eslambolchi. ¶¶16,21,23,27,31,36; JA2081-86. All the AT&T defendants except for AT&T and Eslambolchi served as directors of At Home. ¶36;JA2086. The other defendants are as follows.

Defendants Cox and AT&T were At Home's largest customer and largest shareholder. Comcast also was a major shareholder and large customer of At Home. Their respective designees, defendants David Woodrow and Brian Roberts, were Series B directors of At Home whose unanimity was required for certain board actions. ¶¶17-18,33,35;JA2082,2085,2086.

Edward S. Rogers was a Class A director for the public shareholders, a substantial shareholder, and his cable company was a substantial customer of At Home. ¶34;JA2085-86.

Defendant Dr. John C. Malone was a large shareholder and director of both AT&T and At Home. SPA11,¶32;JA208,1325.

Non-Customer Defendants. Defendant Kleiner Perkins Caufield & Byers owned an interest in At Home and appointed two directors, defendants L. John Doerr and William R. Hearst III, who also was a Class A director for the public shareholders. ¶¶19,28,29;JA2082;2084. Defendants George Bell and Thomas A. Jermoluk were CEOs and directors, and defendant Mark McEachen was Chief Financial Officer of At Home. ¶¶20,22,29;JA2082-84.

AT&T was responsible as a control person of At Home under Section 20(a) of the Securities Exchange Act of 1934. ¶16;JA2081-82. In At Home's filings with the SEC, the following representation was made repeatedly:

> We regard our intellectual property, including our patents, copyrights, trademarks, trade secrets, and similar intellectual property as critical to our success. We rely upon patents, trademark and copyright law, trade secret protection and confidentiality or license agreements to protect our proprietary rights.

¶¶59(x),65(a),96;JA2106,2110-11,2131.

The foregoing protection of At Home's proprietary and "critical" intellectual property enabled At Home to continue to charge its cable customers approximately 30% of the fees for the monthly subscriptions that the cable companies charged their customers. ¶¶91(e),98;JA2127-28,2131-32. This protection of At Home's proprietary intellectual property justified NASDAQ's market expectations of a substantial future cash flow for At Home, ¶8;JA2080, and a substantial At Home stock price. *Id.*[2]

Without this protection, At Home had virtually nothing, and its stock was worth virtually zero. ¶6;JA2079. However, by September 1999, the AT&T defendants had formulated an undisclosed scheme to lie to the market for At Home stock in order "to drain all of

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2. Merton H. Miller & Franco Modigliani, *Dividend Policy, Growth, and the Valuation of Shares*, 34 J.Bus. 411 (1961).

the proprietary technology out of At Home" (¶98(f);JA2132), use At Home's technology to start a competing business at AT&T (¶¶6,59(e);JA2079,2095), "weaken At Home's financial situation" (¶91(d);JA2127), "end At Home's life" (¶93;JA2129), and "inherit At Home's customers." ¶¶80,86,89(b),98(f),100,103; JA2119,2124-25,2132,2134.[3]

3. The AT&T Defendants' Nineteen Misappropriations And $400,000,000 Payment To The Bankrupt At Home Bondholders' For Misappropriating At Home's Intellectual Property

Pursuant to this scheme, the AT&T defendants' misrepresentations enabled them to commit at least **nineteen** separate misappropriations of At Home's intellectual property. ¶¶59,65,77,79-92,100,103,107; JA2094,2210,2118-28,2132,2134,2135. Each of these takings is alleged in great detail in plaintiffs' complaint. *Id.*

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3. Except for AT&T, At Home's customer shareholders were all cable television, not technology, companies. ¶¶3,49,52;JA2078, 2089-90. AT&T had vast experience in various "narrow band" technologies. But AT&T had no experience with the specific broad band technology that At Home had mastered in order to bring high-speed internet access to homes and offices over television cables.

Also, AT&T had gone deep into debt (80 billion dollars) on a "bet the company" scheme to become the largest cable television operator. ¶¶55(c),59(c); JA2092,2094. AT&T was going to make this bet pay off by transforming its cable wires into a high-speed internet. ¶¶59(e),59(i),59(q),63(a)-(b); JA2095,2097,2104,2109. But, in order to service this debt, AT&T wanted to keep the 30% of its revenues that it was paying to At Home and also obtain for itself At Home's revenues from cable customers Cox and Comcast (*see* fn.1) by misappropriating At Home's intellectual property. ¶¶3,59(c),66; JA2078,2094,2111-12.

AT&T's extremely high number of misappropriations just happened to encompass **all aspects of At Home's intellectual property.** ¶¶6,59-65;77-89;JA2079,2094-2111,2118-2126. This included At Home's patented network architecture (¶81;JA2120), At Home's proprietary technology for implementing that architecture (¶¶81-83;JA2120-22), At Home's proprietary technology for customer communications, and all other aspects of At Home's proprietary technology and know-how. ¶¶84-85;JA2122.[4]

As a result of the foregoing, AT&T paid $400,000,000 to settle the bankrupt At Home bondholders' claims that AT&T misappropriated At Home's proprietary technology in order to start a competing business and supplant At Home. ¶¶6,59(e) and (q),87;JA2079,2095, 2104,2124.

4. Chronology: The AT&T Defendants Had To Make Escalating Misrepresentations In Order To Enable Them To Misappropriate At Home's Most Sensitive Intellectual Property

a. The Initial Misrepresentations Inflated The Price of At Home Stock

During September-November 1999, AT&T was able to misappropriate At Home's important proprietary back office system ("BOS") technology for data searches and

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4. AT&T also acquired expensive hardware that copied the proprietary hardware that At Home used to operate its proprietary technology and network. ¶¶88,110-111;JA2124,2136. AT&T, per Scott Russell and others, admitted to At Home engineers that AT&T intended to use At Home's proprietary technology, which AT&T had taken on AT&T's duplicate "head end" hardware in order to duplicate At Home's service. ¶¶79(c);JA2119,2124.

troubleshooting; without this, AT&T could never have started its competing network. ¶¶58(g)-(h) and (j),118;JA2096-97,2140.

In order to avoid detection of their misappropriation of At Home's intellectual property and continue their scheme without detection, the AT&T defendants had to participate in lies contained in At Home's representations to the market for At Home stock. For example, in At Home's filings with the SEC on and before November 16, 1999, it was represented as follows:

> We regard our intellectual property, including our patents, copyrights, trademarks, trade secrets, and similar intellectual property as critical to our success. We rely upon patents, trademark and copyright law, trade secret protection and confidentiality or license agreements to protect our proprietary rights.

¶¶59(x),65(a),96;JA2106,2110-11,2131. This representation was false and misleading for many reasons. These included the AT&T defendants' undisclosed scheme and misappropriations, and the fact that the represented confidentiality and trade secret protections were not in place between At Home and, its largest customer, AT&T. ¶¶59(x),65(b);JA2106,2111,2131.

Absent disclosure of these misappropriations and the malign scheme of At Home's largest customer and shareholder to destroy At Home, persons purchasing At Home's stock on the efficient NASDAQ market bought into twin mirages: (1) a "normal company mirage" in which the largest customer and shareholder of At Home

was apparently not out to destroy At Home; and (2) a "proprietary technology mirage" in which At Home's apparently exclusive control and possession of its proprietary "keys to the internet" technology provided reasonable expectations of substantial future cash flow.

The AT&T defendants' undisclosed scheme artificially inflated the prices of At Home stock throughout the Class Period.

b. Some of The Scheme's Later Misrepresentations Decreased At Home's Stock Price Substantially

However, resistance by At Home officers stopped AT&T from misappropriating many other parts of At Home's proprietary intellectual property **during 1999.** ¶¶59(k),118(A)(1);JA2097-2102,2141. Without At Home's more important intellectual property, AT&T could not duplicate At Home's proprietary technology, end its payments to At Home, and take At Home's customers.

In order to overcome such resistance, the AT&T defendants escalated their scheme and began themselves to make direct misrepresentations to the market for At Home stock. AT&T intended these misrepresentations to reduce At Home's stock price, weaken At Home into complying with AT&T's demands for At Home's most important intellectual property and increase AT&T's control over At Home. *E.g.*, ¶¶49(k),60,91(b)-(d),100,103,119;JA2097,2107,2126-27,2132,2134,2147. These deceptions did reduce At Home's stock price and somewhat reduce the artificial inflation of such price caused by the undisclosed scheme.

On December 6, 1999, over At Home's objections, and at a time when At Home was preparing for a new equity issuance, AT&T represented that AT&T supposedly would implement customer choice for internet companies other than At Home (*i.e.*, "open access"). ¶¶59(k),118(A)(1);JA2097,2141. This "open access" representation was false because AT&T never intended to implement and never did implement open access. ¶60;JA2107. On the contrary, AT&T's corporate properties and interests were harmed in many ways by open access and AT&T actively opposed open access in legal briefs. *Id.* However, simultaneously with this "sham" public announcement, AT&T made internal demands upon At Home to turn over virtually all of its proprietary technology to AT&T based on the pretext of a need to prepare to conduct tests for "open access". ¶79(a);JA2097-98. Although open access was never implemented and AT&T never intended to implement it, the weakened At Home did turn over further intellectual property to AT&T in connection with the open access tests. ¶¶59(f) and (k);JA2095-2102.

AT&T's false December 6, 1999 announcement made pursuant to the scheme caused the price of At Home stock to plummet by 15% (and by more thereafter). ¶59(k);JA2097. This partially decreased the inflation that AT&T's scheme had earlier caused.

c. False Representations To Agree To Buy Control Blocks of Stock At The Reduced Price

Still, At Home's officers sought to refuse to divulge to AT&T the most sensitive intellectual property that AT&T needed to duplicate At Home's technology. This caused AT&T to commit its second, escalating misrepresentation in late March 2000. AT&T then announced that, subject to At Home's stockholders' approval, AT&T had agreed to purchase the control blocks of At Home stock held by defendants Cox and Comcast (*see* fn. 1) by paying more than $1,000,000,000 in AT&T stock to each. Such purchase price was to be at the then market price of At Home stock. This price had been decreased by AT&T's "open access" representation, thereby providing AT&T with a substantially lower cost to purchase the Cox and Comcast control blocks of At Home's stock. ¶63;JA2109. AT&T's purchase was subject to approval by At Home shareholders and, if approved, would increase AT&T's position to 23% equity control, and 74% overall voting control, of At Home. ¶70(b);JA2114.

In order to secure shareholder approval of these purchase transactions,[5] AT&T, per defendant Armstrong, its Chairman, represented in a stock market "squawk box" public interview that the March 28, 2000 Agreements were a "new commitment by AT&T . . . to

5. At Home's Class A shares were owned by the public shareholders. AT&T had no voting control over those shares. The separate approval of the Class was necessary to approve the transactions necessary for AT&T's purchases of the At Home stock owned by Cox and Comcast.

. . . [At Home]", which should "eliminate the uncertainty" about At Home. ¶63(a);JA2109. Defendant Armstrong further represented that "the people, **the marketplace**, and the customers now can feel with a great deal of certainty the commitment of AT&T . . . to . . . Excite At Home." *Id.* [Emphasis supplied.] (This uncertainty had been created, in large part, by AT&T's deceptive December 6, 1999 "open access" announcement.)

AT&T's foregoing assurances to the "marketplace" for At Home stock were grossly false and misleading. ¶63(b);JA2109. In fact, the March 28, 2000 agreements were an escalation in AT&T's ongoing efforts to take At Home's proprietary technology and customers. ¶¶59(t),60-65;JA2105,2107-2111. The only "commitment" reflected by such agreements was to buy-off the other control person customers so that AT&T would have clear sailing to misappropriate At Home's intellectual property, end its life, and take Cox and Comcast as customers of AT&T. ¶¶66,118(A)(2);JA2111-12,2141-42. Contrary to AT&T's assurance, these agreements were **not** a commitment by AT&T to the success of At Home. Consistent therewith, AT&T had no intention to enter, and did not enter, the new agreement with At Home, despite AT&T's representations to the contrary on March 29, 2000. ¶¶60-65,80,93;JA2107-11,2119,2129.

As the markets digested AT&T's deceptive statements and the accompanying SEC filings in late March and early April 2000, such statements caused the price of At Home stock to plummet by 60% over a four-week period. ¶59(t),118(A)(4); JA2105,2143.

The announcement of the March 28, 2000 Agreements, and the AT&T defendants' associated false assurances to the "marketplace," successfully accomplished the AT&T defendants' purpose to gain unfettered access to At Home's proprietary intellectual property. Immediately after this announcement, At Home began, according to its Chief Technology Officer, to give AT&T unfettered access to At Home proprietary technology (¶63(b);JA2109).

Moreover, defendants' deceptions also caused At Home shareholders to provide the necessary vote approving AT&T's purchase agreement transactions. In this regard, defendants failed to comply with SEC Item 404, 17 CFR § 229.404(a) when issuing At Home's May 28, 2000 Proxy **as well as in all other SEC filings** made during the Class Period. This SEC rule requires disclosure of related party transactions:

> *Transactions With Management and Others.* Describe briefly any transaction, or series of similar transactions, since the beginning of the registrant's last fiscal year, or any currently proposed transaction, or series of similar transactions, to which the registrant or any of its subsidiaries was or is to be a party, in which the amount involved exceeds $60,000, and in which any of the following persons had, or will have, a direct or indirect material interest . . . (1) Any director or executive officer of the registrant; (2) Any nominee for election as a director; (3) Any security holder who is known to the registrant to own more than five percent of any class of the registrant's voting securities . . .

AT&T's undisclosed nineteen takings of At Home's proprietary technology involved, in aggregate, more than $400,000,000 in At Home's property, including its proprietary technology, because that is what AT&T paid to settle the bankrupt At Home bondholders' claims of misappropriation. ¶110;JA2136. Each taking of At Home's proprietary technology, and the series of takings together, plainly represent a "transaction," as well as a series of transactions, of in excess of $60,000 between At Home and its "security holder who is known to own more than 5%" of At Home stock.

The failures to disclose the inherently deceptive act of control person misappropriation from the issuer constitute a clear violation of the applicable SEC rule designed to compel such disclosures.

d. AT&T's Continued Deceptive Statements Consummate Its Scheme

Once AT&T had obtained At Home shareholder approval of AT&T's control of At Home in September 2000, AT&T embarked on a series of steps to complete its takings of all of At Home's intellectual property, force At Home into bankruptcy, start AT&T's replacement network, effect a merger of part of AT&T and Comcast, and secure Cox and Comcast as new customers for AT&T's new network. ¶¶6,36,58,59(k)(6)-(11),69,70,72,91-107;JA2079,2086,2093,2097-102,2112-15,2126-35. The steps that weakened At Home and eventually forced At Home into bankruptcy included the withholding of revenues due to At Home by AT&T, Cox and Comcast; AT&T's causing At Home to overspend its budget; and AT&T's deceptive statement to At Home that AT&T would provide financing to At Home when, in fact,

AT&T had no such intention. ¶¶66,75(c)-(d),91(c)-(d),100;JA2111-12,2116-17,2127,2132-33.

As a direct result of AT&T's deceptive and associated steps pursuant to its scheme, At Home was compelled to enter into unfavorable ("death spiral") financing. ¶100;JA-2133. When announced on June 8, 2001, this caused a 52% drop in At Home's share price. *Id.* Ultimately, the AT&T defendants' scheme caused a total loss of the investment of those persons who purchased At Home stock and did not sell same.

5. Procedural History

In a series of orders from September 18, 2003 through August 9, 2004, reproduced at App. 46a-53a, the district court initially denied defendants' F.R.C.P. Rule 12(b)(6) motions to dismiss the Rule 10b-5 claims. After this Court's decision in *Dura Pharmaceuticals v. Broudo*, 544 U.S. 336 (2005), the court held that that portion of defendants' integrated scheme that was concealed by their misrepresentations could not comprise part of a scheme "in connection with the purchase or sale of securities" within the meaning of Rule 10b-5. App. 27a-29a. With the violative scheme reduced to merely the misrepresentations, the district court held that, under *Dura*, plaintiffs had failed to plead that their loss was caused by either a disclosure to the market of the misrepresentation or a materialization of the risk concealed by the misrepresentation. *Id.* 33a.

The Second Circuit affirmed by Order dated July 9, 2007 ("Order"). It held that the scheme was not "in connection with the purchase or sale of securities" under Rule 10b-5, *id.*, citing *Mutual Shares Corp. v. Genesco, Inc.*, 384 F.2d 540 (2d Cir. 1967). It also held, for

"substantially the reasons set forth by the district court," that plaintiffs had failed to plead loss causation from the misrepresentations. *Id.* 3a-4a.

REASONS FOR GRANTING THE PETITION

The scope of deceptive practices prohibited by § 10(b) is a recurring issue in the federal courts, including this Court. This Court granted certiorari in *Stoneridge Investment Partners v. Scientific-Atlanta, Inc.*, No. 06-43 ("*Stoneridge*"), to consider whether that scope extends to "deceptive devices and contrivances" by a defendant who makes no affirmative misrepresentations, but whose deceptive acts are concealed by and are part of an issuer's scheme and misrepresentations to the market.[6] *See also The Regents of the University of California v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 482 F.3d 372 (5th Cir. 2007), *petition for cert. filed* (April 5, 2007) (No. 06-1341) (raising virtually the same question of whether the scope of deceptive practices prohibited by §10(b) extends to non-speakers whose deceptive acts are concealed by and part of the issuer's misrepresentations to the market) ("*Regents*").

In conflict with *Stoneridge* and *Regents*, *Simpson v. AOL Time Warner, Inc.*, 452 F.3d 1040 (9th Cir. 2006), *petition for cert. filed* (Oct. 19, 2006) (No. 06-560) ("*Simpson*") held that deceptive practices of non-speakers are within the scope of acts prohibited by §10(b) where they further the scheme of an issuer who made misrepresentations to the market.

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6. Petitioners believe that this case should be reviewed with *Stoneridge* to afford resolution of the closely related scheme liability issues. In the alternative, certiorari should be granted and this case held pending disposition of *Stoneridge*.

The Order constricts the scope of acts prohibited by §10(b) in a manner that conflicts with each of the Fifth, Eighth and Ninth Circuits and the prior rulings of this Court. The Order holds not only that must the violator make misrepresentations. Also, the violator's unlawful and deceptive acts concealed by those misrepresentations are excluded from the prohibition of Rule 10b-5 against a deceptive scheme or artifice "in connection with the purchase or sale of securities." This directly conflicts with the scope of prohibition found in *Simpson* and prior decisions of this Court. *SEC v. Zandford*, 535 U.S. 813 (2002); *Superintendent of Ins. of N.Y. v. Bankers Life & Casualty Co.*, 404 U.S. 6 (1971); *Affiliated Ute Citizens v. United States*, 406 U.S. 128 (1972).

Similarly, the Order conflicts with the Exchange Act's requirements for proving loss causation and this Court's prior securities law causation decisions, including *Dura Pharmaceuticals v. Broudo*, 544 U.S. 336 (2005). Over three thousand cases have cited to *Dura*. A current and recurring issue of great importance in the federal securities laws is what private plaintiffs must allege in tracing loss causation from the violation to the decline in the share price.

Section 21D(b)(4) of the Exchange Act, 15 U.S.C. § 78u-4(b)(4), provides that a private plaintiff must prove "that the act or omission of the defendant alleged to violate this chapter caused the loss for which the plaintiff seeks to recover damages." By alleging that certain of the defendants' misrepresentations directly caused the price of the stock to decline, plaintiffs alleged facts that, if proved, complied with the implied requirements of

Section 21D(b)(4). In dismissing on loss causation grounds, the Order clearly conflicts with Section 21D(b)(4).

The Order also conflicts with *Dura*, which recognizes that where a misrepresentation causes a later act which, in turn, causes the stock price to decline, a private plaintiff satisfies loss causation. Here, plaintiffs alleged that defendants' scheme caused the stock price to decline and also caused other acts, which caused the stock price to decline. By holding that plaintiffs failed to meet the *Dura* standard for pleading loss causation, the Order conflicts with *Dura*.

This Court has recognized the need for certainty and predictability in the securities area, and the Second Circuit handles a large volume of securities cases. Granting the Petition to clarify the scope of prohibited conduct and the pleading of causation will resolve the conflict between the Order and all the foregoing authority on these important and recurring issues in securities law.

Granting certiorari also satisfies basic justice precepts of redressing injuries caused by fiduciaries who steal sensitive property from their beneficiary, lie to the market about their thefts, and also lie to the market about related matters in order to enable themselves to consummate their scheme to steal the most sensitive property and customers of their beneficiary.

As important as it may be to rein in some private actions under the federal securities laws, it is equally important that in the process egregious violations of Section 10(b) not be immunized. Granting certiorari will allow this Court to manage this process so as to maintain that balance.

I. IN CONFLICT WITH OTHER CIRCUITS, THIS COURT'S OWN PRIOR DECISIONS, AND THE PLAIN LANGUAGE OF RULE 10b-5, THE ORDER EFFECTIVELY LIMITS THE SCOPE OF CONDUCT PROHIBITED BY RULE 10b-5 SOLELY TO MISREPRESENTATIONS

A. Conflicts With Prior Decisions Of This Court

The Order held that only defendants' misrepresentations were in connection with the purchase or sale of securities within the meaning of Rule 10b-5, and that the deceptive and unlawful acts that the misrepresentations concealed were not in connection with the purchase or sale of securities. App. 3a (court of appeals opinion); *id.* 25a-29a (district court opinion).

This holding conflicts with prior decisions of this Court. *SEC v. Zandford*, 535 U.S. 813 (2002) (deception created by breach of fiduciary duty to disclose sales of securities and conversion of proceeds constitutes scheme in connection with purchase or sale of securities); *Superintendent of Ins. of N.Y. v. Bankers Life & Casualty Co.*, 404 U.S. 6 (1971).

Where misrepresentations conceal breaches of fiduciary duty, such breaches are part of the fraud in connection with the purchase or sale of securities. *E.g.*, *Affiliated Ute Citizens v. United States*, 406 U.S. 128 (1972) (misstatements of material fact used by bank employees in position of market maker to acquire stock at less than fair value); *Superintendent*, (seller (of bonds) was duped into believing that it, the seller, would receive the proceeds). *Cf. SEC v. Capital Gains Research*

Bureau, 375 U.S. 180 (1963) (injunction under Investment Advisers Act of 1940 to compel registered investment adviser to disclose to his clients his own financial interest in his recommendations). *Compare Santa Fe Indus. v. Green*, 430 U.S. 462 (1977) (where no misrepresentation is alleged, mere breach of fiduciary duty did not violate Rule 10b-5).

In *Zandford*, the Court emphasized that "neither the SEC nor this Court has ever held that there must be a misrepresentation about the value of a particular security in order to run afoul of the Act." 535 U.S. at 820. There a broker's sale of his customers' securities with the undisclosed intent to misappropriate the proceeds constituted a fraudulent scheme "in connection with the purchase or sale of any security."

> [E]ach sale was made to further respondent's fraudulent scheme; each was deceptive because it was neither authorized by, nor disclosed to, the Woods. . . . Indeed, each time respondent 'exercised his power of disposition for his own benefit,' **that conduct, 'without more,' was a fraud**. . . .
>
> . . . . The fact that respondent misappropriated the proceeds of the sales provides persuasive evidence that he had violated § 10(b) when he made the sales, **but misappropriation is not an essential element of the offense. . . . It is enough that the scheme to defraud and the sale of securities coincide.**

Id. at 820-23 (citations omitted) (emphasis supplied). *Zandford* concerned neither misrepresentations nor

omissions, but deceptive conduct. Here, far more than in *Zandford*, the violator engaged in affirmative misrepresentations that "we protect" the IP in order to enable itself to misappropriate such IP through these and other escalating misrepresentations and deceptions in an integrated scheme or artifice. *See* Statement of the Case *supra*. This scheme inflated the market price of At Home stock and, thus, satisfied the "in connection with" test in a way that *Zandford* did not. *See Zandford*, 535 U.S. at 822 (inflation of publicly traded securities prices sufficient though not necessary to satisfy the "in connection with" test). Thus, the Order directly conflicts with *Zandford* in this respect.

Moreover, one of the deceptions that the violator used to misappropriate the IP here successfully induced shareholder approval of AT&T's purchase of control blocks of stock of At Home owned by Cox and Comcast. *See* Statement of the Case *supra*. This purchase increased AT&T's control over At Home to the following point: At Home's most sensitive IP, which At Home had previously resisted turning over to AT&T, was then provided to the omnipotent AT&T. This "coinciding" of the scheme and the purchase or sale of securities was what satisfied and was "enough" to satisfy the "in connection with" test in *Zandford*. Here, also, AT&T's scheme employed AT&T's purchase of securities, **and shareholder approval thereof**, to effect the scheme. Even more than in Zandford, such scheme or artifice was in connection with the purchase and sale of securities. This constitutes a second conflict between the Order and *Zandford*.

Third, the Order appears to hold that "nothing in the SEC regulations required that defendants disclose the misappropriation scheme." App. 4a (court of appeals); *see id.* 26a, 31a (district court). However, SEC Regulation S-K, Item 404(a), 17 CFR § 229.404(a), as then in effect expressly required disclosure of related party transactions as follows:

> *Transactions With Management and Others.* Describe briefly any transaction, or series of similar transactions, since the beginning of the registrant's last fiscal year, or any currently proposed transaction, or series of similar transactions, to which the registrant or any of its subsidiaries was or is to be a party, in which the amount involved exceeds $60,000, and in which any of the following persons had, or will have, a direct or indirect material interest . . . (1) Any director or executive officer of the registrant; (2) Any nominee for election as a director; (3) Any security holder who is known to the registrant to own more than five percent of any class of the registrant's voting securities . . .

Thus, even more than in *Zandford*, the misappropriation here triggered an explicit SEC disclosure requirement designed to inform prospective or actual shareholders about any looting or improper transactions by insiders of an issuer of public stock. *Zandford* merely involved general fiduciary principles. Clearly, the unlawful scheme here was, *in toto*, in connection with the purchase or sale of securities. This constitutes a third conflict between the Order and *Zandford*.

Zandford relied upon *Superintendent*. There the directors of Manhattan Casualty Company authorized the sale of treasury bonds because they had been "duped" into believing that the company would receive the proceeds of the sale. 404 U.S. at 9. The Court held that "Manhattan was injured as an investor through a deceptive device which deprived it of any compensation for the sale of its valuable block of securities." *Id.*, at 10. The Court explicitly rejected the Second Circuit's narrow reading of § 10(b) in *Superintendent of Ins. of N.Y. v. Bankers Life & Casualty Co.*, 430 F.2d 355, 361 (2d Cir. 1970),[7] that because the fraud against Manhattan did not occur on a securities exchange, it was not prohibited by § 10(b). 404 U.S. at 10. Noting that § 10(b) "must be read flexibly, not technically and restrictively," *id.* at 12, the Court stated that while the interest in "preserving the integrity of the securities markets" was one of the purposes of the statute, it was not limited to that objective. *Id.*

Here, At Home stock was traded on the Nasdaq and the "integrity of the market" test is satisfied, though it is not necessary to satisfaction of the "in connection with" test. However, relying on *Mutual Shares Corp. v.*

7. This Court again found fault with the Second Circuit's narrow reading of § 10(b)'s "in connection with" language in *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Dabit*, 547 U.S. 71, 85 (2006) ("Under our precedents, it is enough that the fraud alleged 'coincide' with a securities transaction – whether by the plaintiff or by someone else. The requisite showing, in other words, is 'deception "in connection with the purchase or sale of any security," not deception of an identifiable purchaser or seller.'") (citations omitted).

Genesco, Inc., 384 F.2d 540 (2d Cir. 1987), the district court determined below that

> the scheme alleged here involved corporate abuse, misconduct and diversion of assets, but no transactions in the relevant securities. Its success depended on the misappropriation of At Home's proprietary technology, without regard to any transactions in At Home stock. . . .
>
> The PTAC does allege that in March 2000 AT & T increased its control over At Home by acquiring At Home shares from Cox and Comcast in exchange for AT & T shares. However, an otherwise legitimate stock transaction that is antecedent, but not integral, to the alleged fraud does not meet the 'in connection with' requirement. *See Zandford*, 535 U.S. at 820, 122 S.Ct. 1899 (neither an otherwise legitimate securities transaction that is an independent event from the alleged fraud, or is merely followed by the theft of the proceeds of the transaction, supports a claim under Section 10(b)). Indeed, the defendants in *Mutual Shares*, like AT & T here, acquired a controlling position in the issuer before carrying out their scheme, 384 F.2d at 542, but the Court of Appeals nevertheless dismissed plaintiffs' claim based on the subsequent diversion of assets from the issuer. *Id.* at 546.

App. 27a-28a. The district court's above "finding" is contrary to the plain allegations of the complaint that the integrated scheme had gone on for six months **before**

AT&T had to escalate the scheme. AT&T then made expensive purchases of At Home stock in order to misappropriate the most sensitive IP from At Home, which had theretofore resisted divulging same.

Also, in *Mutual Shares*, plaintiffs alleged that defendants, as part of the tender offer through which they would become controlling shareholders of a public company, defrauded them by remaining silent as to (1) their true intentions to manage the acquired company for their benefit, and (2) the actual (higher) value of real estate owned by the acquired company. 384 F.2d at 544. Plaintiffs were not sellers to defendants in the tender offer but were purchasers (at allegedly depressed prices) who continued to hold their shares, and who **failed to allege that defendants had any non-public information as to the value of the real estate.** *Id.* at 544-45. The Court characterized the secret intention to abuse the acquired company as a "failure to disclose by an outsider," or "at best" an allegation "that defendants impliedly represented to the world at large that they would not mismanage [the acquired company] if they acquired control and that plaintiffs relied on this when they bought their . . . stock. Plaintiffs cite no cases in which [Rule 10b-5] has been applied in this expansive manner, nor have we been able to find any." *Id.* at 545 (footnote omitted).

In contrast, AT&T was an insider and control person which was misappropriating IP and falsely stating that the IP was protected **at the same time** that it was engaged in other misrepresentations to enable it to misappropriate the IP. Only after its scheme had long been under way, did AT&T purchase additional control

blocks of At Home stock on false pretenses in order to enable it to misappropriate the most sensitive parts of At Home's IP. AT&T's undisclosed and unlawful scheme had been inflating the prices of At Home stock paid by plaintiffs long before AT&T engaged in its lies to induce shareholder approval of AT&T's purchase of the control block of At Home's stock. Thus, *Mutual Shares* is extremely distinguishable.

Similarly, the Order conflicts with other decisions of this Court insofar as the Order severed the deceptive and unlawful acts concealed by the misrepresentations from the integrated scheme or artifice. Having thus severed these deceptive acts, the Order erroneously held that they are not prohibited by Section 10(b). But prior decisions of this Court hold to the contrary. *Affiliated Ute Citizens*; *SEC v. Capital Gains Research Bureau*, 375 U.S. 180 (1963). Certiorari should be granted to resolve all of the foregoing conflicts between this Court's prior decisions and the Order.

B. The Order Conflicts With The Plain Language Of The Statute And Rule

Under the plain language of the statute, defendants' integrated scheme or artifice, *in toto*, constitutes a violation of the statute "in connection with" plaintiffs' purchases and sales of At Home's securities as well as AT&T's purchases. Under extensive precedent of this Court, it is incorrect to dumb down "scheme" or "artifice" violations into merely the "misrepresentation."

Thus, the Order further conflicts with this Court's clear precedent that statutes be interpreted in accordance with their plain language.

This Court has often stated that it will rely on the text of the statute to determine the scope of rights and remedies under the Exchange Act. For example, in granting certiorari in *Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A.*, 508 U.S. 959 (1993), the Court *sua sponte* directed the parties to brief the question "[w]hether there is an implied private right of action for aiding and abetting violations of Section 10(b) of the Securities Exchange Act of 1934 and SEC Rule 10b-5." In holding that there was no such implied right of action, the Court relied almost exclusively on the text of Section 10(b), which does not reach actors who aid and abet a violation of the section by another.

> With respect . . . to . . . the scope of conduct prohibited by § 10(b), the text of the statute controls our decision. . . . We have refused to allow 10b-5 challenges to conduct not prohibited by the text of the statute.

Central Bank of Denver, N.A. v. First Interstate Bank of Denver, N.A., 511 U.S. 164, 173 (1994).[8] *See also Santa*

8. The Court further noted that

> [t]he absence of § 10(b) aiding and abetting liability does not mean that secondary actors in the securities markets are always free from liability under the securities Acts. Any person or entity, including a lawyer, accountant, or bank, who employs a manipulative device or makes a material misstatement (or omission) on which a purchaser or seller of securities relies may be liable as a primary violator under 10b-5, assuming *all* of the requirements for primary liability under Rule 10b-5 are met.

511 U.S. at 191.

Fe Indus., 430 U.S. at 472-74; *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 197 (1976) ("In addressing [the elements of a cause of action under Section 10(b) and Rule 10b-5], we turn first to the language of § 10(b), for '[t]he starting point in every case involving construction of a statute is the language itself.'" (quoting *Blue Chip Stamps v. Manor Drug Stores*, 421 U.S. 723, 756 (1975) (Powell, J., concurring))).

Moreover, a "statute must, if possible, be construed in such fashion that every word has some operative effect." *United States v. Nordic Village, Inc.*, 503 U.S. 30, 36 (1992). *See also Duncan v. Walker*, 533 U.S. 167, 174 (2001) ("It is our duty to give effect, if possible, to every clause and word of a statute."). Here the critical language of § 10(b) makes it unlawful "for any person, directly or indirectly . . . [t]o use or employ . . . any . . . deceptive device or contrivance." The Court has understood "device" to mean "that which is devised, or formed by design; a contrivance; an invention; project; scheme; often, a scheme to deceive; a stratagem; an artifice." "Contrivance," according to the Court, means "a thing contrived or used in contriving; a scheme, plan or artifice." *Hochfelder*, 425 U.S. at 199 n. 20 (quoting Webster's New International Dictionary 580, 713 (2d ed. 1934).

In construing the "in connection with" language of Section 10(b) and Rule 10b-5 to extend only to certain misrepresentations, the Order conflicts with Congress' plain language and prior decisions of this Court interpreting this language.

Moreover, numerous decisions of this Court make clear that Section 10(b) "should be 'construed not technically and restrictively, but flexibly to effectuate its remedial purposes.'"[9] Flexible construction of the plain language of the statute does not permit a narrow interpretation which would require, absent textual support, that a "deceptive device or contrivance" be permitted when Congress and the SEC have prohibited same. The Order conflicts with the prior decisions of this Court in this respect as well.

C. Conflict With Other Circuits

In each of three recent circuit court decisions construing the scope of conduct prohibited by Rule 10b-5, the court held that deceptive acts could constitute, together with misrepresentations, a scheme or deception in violation of Rule 10b-5.

In *Simpson*, plaintiffs alleged that defendants engaged in a scheme to overstate the reported revenues of Homestore.com by entering into sham transactions in which payments were made to Homestore, which then returned monies to the "vendors."

> We conclude that conduct by a defendant that had the principal purpose and effect of creating a false appearance in deceptive

9. *E.g.*, *Zandford*, 535 U.S. at 819, quoting *Affiliated Ute Citizens*, 406 U.S. at 151 (internal quotation marks omitted); *accord*, *Pinter v. Dahl*, 486 U.S. 622, 653 (1988); *Herman & MacLean v. Huddleston*, 459 U.S. 375, 386-87 (1983); *Santa Fe Indus.*, 430 U.S. at 475-76; *Superintendent*, 404 U.S. at 12; *SEC v. Capital Gains Research Bureau, Inc.*, 375 U.S. 180, 195 (1963).

> transactions as part of a scheme to defraud is conduct that uses or employs a deceptive device within the meaning of § 10(b). Furthermore, such conduct may be in connection with the purchase or sale of securities if it is part of a scheme to misrepresent public financial information where the scheme is not complete until the misleading information is disseminated into the securities market. Finally, a plaintiff may be presumed to have relied on this scheme to defraud if a misrepresentation, which necessarily resulted from the scheme and the defendant's conduct therein, was disseminated into an efficient market and was reflected in the market price.

452 F.3d at 1050-52. The court affirmed the dismissal of Rule 10b-5 claims but remanded to allow plaintiffs to seek leave to replead under the new standard. *Id.* at 1048.

By limiting the scope of conduct prohibited by Rule 10b-5 to misrepresentations, and by further excluding deceptive conduct from consideration as part of a scheme to defraud, the Order directly conflicts with the Ninth Circuit's decision in *Simpson*.

The scope of conduct prohibited by Rule 10b-5 is currently before this Court in *Stoneridge*. There, the Eighth Circuit refused to hold non-speaking defendants liable under § 10(b) for a course of business whose sole purpose was to allow a public company to report falsely inflated earnings. In so limiting the scope of prohibited conduct, the Eighth Circuit adopted a "bright line" test:

> [A]ny defendant who does not make or affirmatively cause to be made a fraudulent statement or omission, or who does not directly engage in manipulative securities trading practices, is at most guilty of aiding and abetting and cannot be held liable under § 10(b) or any subpart of Rule 10b-5.

443 F.3d at 992.

In *Regents*, the Fifth Circuit adopted the Eighth Circuit's bright line test, requiring misrepresentations or omissions in a private § 10(b) action. Defendant were alleged to have participated in transactions which allowed Enron Corp. to take liabilities off its books temporarily and to book revenues from transactions when it was actually incurring debt. The Fifth Circuit cited the split between the Eighth and Ninth Circuits on the issue of scheme liability in the absence of misrepresentation, aligning itself with the Eighth Circuit in *Stoneridge*.

> An act cannot be deceptive within the meaning of § 10(b) where the actor has no duty to disclose. . . .
>
> [T]he Court, in its . . . cases interpreting § 10(b), has established that a device, such as a scheme, is not 'deceptive' unless it involves breach of some duty of candid disclosure.

482 F.3d at 386, 389 (citations and footnotes omitted). However, neither *Stoneridge* nor *Regents* went so far as to exclude the deceptive non-speaking conduct

altogether from the scope of prohibited activity. In doing so, the Order goes far beyond and conflicts with *Stoneridge* and *Regents* as well. Granting certiorari is necessary to resolve the foregoing conflicts on the recurring and important issue of the scope of conduct prohibited by Section 10(b).

II. THE ORDER'S LOSS CAUSATION RULING CONFLICTS WITH 15 U.S.C. § 78u-4(b)(4) AND THE PRIOR DECISIONS OF THIS COURT

A. Conflict with 15 U.S.C. § 78u-4(b)(4)

An additional issue of recurring importance calling for resolution in this case is the conflict between the Order and the text of the Exchange Act setting forth the requirements of proving loss causation. Congress provided that:

> In any private action arising under this chapter, the plaintiff shall have the burden of proving that **the act** or omission **of the defendant alleged to violate this chapter caused the loss** for which the plaintiff seeks to recover damages.

Section 21D(b)(4) of the Exchange Act, 15 U.S.C. § 78u-4(b)(4) (emphasis supplied); App. 57a.

Here, plaintiffs expressly alleged that certain of defendants' misrepresentations on December 6, 1993 and March 29, 2000 directly caused the price of the stock of At Home to decline. *See* Statement of Case *supra*. If proved, these allegations satisfy Section 21D(b)(4). In

holding against plaintiffs, neither the Order nor the district court ever mentioned these misrepresentations that directly decreased the price of At Home stock. Whether intentionally or by inadvertence, the Order, in rejecting loss causation based on these misrepresentations, clearly conflicts with the implied pleading requirement of Section 21D(b)(4).

In this regard, the plain language of Section 21D(b)(4) controls. *See Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 197 (1976), and cases collected at Point I.A. *supra*. The text of §21D(b)(4) does not specify a burden of proving causation from a "statement or omission" or a "misrepresentation or omission," but rather from an "act or omission." Congress thus clearly contemplated that "the act . . . of the defendant alleged to violate this chapter" could include not merely the "act of speaking" but also "any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person," as set forth in Rule 10b-5(c). *See* Point I.A. *supra*.

Absolutely nothing in the statutory text suggests that employment of a "deceptive device or contrivance" in connection with the purchase or sale of securities be limited only to instances where a misrepresentation accompanies the conduct. In this context, plaintiffs separately satisfied §21D(b)(4) by alleging that the violator's deceptions caused other acts (desperation financing) that caused the price of At Home stock to fall. *See* Statement of Case *supra*. By holding to the contrary, the order further conflicts with §21D(b)(4).

Finally, plaintiffs also argued below that they satisfied loss causation by pleading a leak of the truth and the materialization of the concealed risk in numerous respects.

B. Conflict With The Prior Decisions Of This Court

This Court has recognized that "[t]here is . . . more than one way to demonstrate the causal connection" for purposes of Rule 10b-5. *Basic, Inc. v. Levinson*, 485 U.S. 224, 243 (1988). Specifically with regard to loss causation, this Court has held that, in a pure misrepresentation case, causation is adequately pleaded where a misrepresentation allegedly causes a later leak or corrective disclosure that, in turn, causes a decline in the stock price. *Dura*, 544 U.S. at 347. *Dura* specifically relied on common law proximate cause. 544 U.S. at 345. Where intentional harm or injury is alleged, the common law is astute to find causation of injury at the pleading stage.[10]

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10. In *Dura*, this Court cited (twice) to W. Page Keeton, PROSSER & KEETON ON THE LAW OF TORTS § 8 at 37 n. 27 (5th ed. 1984) as an authoritative source of common law proximate cause principles. PROSSER quotes from *Derosier v. New England Tel. & Tel. Co.*, 130 A. 145, 152 (N.H. 1925) (emphasis supplied) as follows:

> In determining how far the law will trace causation and afford a remedy, the facts as to defendant's intent, his imputable knowledge, or his justifiable ignorance are often taken into account. The moral element is the factor that has turned close cases one way or another. **For an intended injury, the law is astute to discover even very remote causation.** For one which the

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Per force, where, as here, plaintiff explicitly alleges that the misrepresentations themselves intentionally caused the decline in the price of the stock, loss causation is adequately pleaded under *Dura* and 15 U.S.C. § 78u-4(b)(4) *supra*. The Order clearly conflicts with *Dura* in this respect.

Similarly, in a scheme case, where the scheme or deceptive acts caused other acts—here including desperation financing—that caused the decline in stock price, loss causation is adequately pleaded under *Dura*'s reasoning. In holding to the contrary, the Order once again directly conflicts with *Dura*.

III. OTHER REASONS FOR GRANTING THE PETITION

Liability under the Exchange Act is "an area that demands certainty and predictability" for those who provide services to participants in the securities business. *E.g.*, *Pinter v. Dahl*, 486 U.S. 622, 652 (1988). The Second Circuit handles a high proportion of actions filed under the federal securities laws. This case presents the opportunity for this Court to provide certainty and predictability regarding the previously demonstrated conflicts in the "in connection with" and the loss causation standards in the context of scheme liability.

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> defendant merely ought to have anticipated it has often stopped at an earlier stage of the investigation of causal connection. And as to those where there was neither knowledge nor duty to foresee, it has usually limited accountability to direct and immediate results.

Granting certiorari also satisfies basic justice precepts of redressing injuries caused by fiduciaries who steal sensitive property from their beneficiary, lie to the market about their thefts, and also lie to the market about related matters in order to enable themselves to consummate their scheme to steal the most sensitive property and customers of their beneficiary.

As important as it may be to rein in some private actions under the federal securities laws, it is equally important that in the process egregious violations of Section 10(b) not be immunized. Granting certiorari here will allow this Court to manage this process so as to maintain that balance.

CONCLUSION

The petition for a writ of certiorari should be granted.

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